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CHARLES ELMORE CROPLEY

Nos. 492 and 493

In the Supreme Court of the United States

OCTOBER TERM, 1938

GENERAL GAS AND ELECTRIC CORPORATION,
PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals in these cases (No. 492, R. 102–108; No. 493, R. 110–116) is unreported. The opinion of the Circuit Court of Appeals (No. 492, R. 117–121; No. 493, R. 125–129) is reported in 98 F. (2d) 561.

JURISDICTION

The judgments of the Circuit Court of Appeals in the two cases were entered September 1, 1938.

(No. 492, R. 123; No. 493, R. 131.)[1] A single petition for writs of certiorari in the two cases was filed December 1, 1938, and was granted January 3, 1939. (No. 492, R. 124; No. 493, R. 132.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

On different dates in 1926, the petitioner's affiliate, the Northern Pennsylvania Power Company, a Pennsylvania corporation, acquired all of the assets of two of its subsidiaries, the North Penn Power Company and the Susquehanna County Light and Power Company, both Pennsylvania corporations, in consideration of the assumption of the liabilities of the subsidiaries and for certain additional consideration. The transfers were both carried out pursuant to Section 595, Title 15, of Purdon's Pennsylvania Statutes. In 1926 and 1927, the transferee redeemed at a premium certain bonds of the transferors which had been issued at a discount. Consolidated returns were filed by the transferee and the petitioner for 1926 and 1927. The question is whether there may be deducted in those returns such portion of the bond discount and expense incurred upon the is-

[1] The opinion was rendered July 18, 1938 (No. 492, R. 117; No. 493, R. 125), but the records do not disclose that judgments were entered until the petition for rehearing was denied (No. 492, R. 123; No. 493, R. 131).

suance of the bonds as had not been amortized at the time of their redemption.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 31–35.

STATEMENT

The facts in these cases were stipulated. Those material to the issues here involved as stipulated and found by the Board of Tax Appeals are substantially as follows:[2]

The petitioner, a Delaware corporation, was engaged, at all times material to these proceedings, in the business of holding securities and thus controlling public utility subsidiaries. (R. 103.)

For the years 1926 and 1927, the petitioner and its affiliated corporations, which included the Northern Pennsylvania Power Company and the Susquehanna County Light and Power Company, filed consolidated income tax returns. By agreement, the total tax liability of the affiliated group is to be assessed against and paid by the petitioner. (R. 103, 106.)

In 1926, the Northern Pennsylvania Power Company (hereinafter called the Northern Power Company) acquired all of the assets and assumed all of the liabilities of the North Penn Power Company, a Pennsylvania corporation (hereinafter called the North Penn Company). This transfer was ef-

[2] Unless otherwise indicated, all references to the record will be understood as referring to the record in No. 492.

fected under the provisions of Section 23 of the General Corporation Act of 1874, as amended by Section 5 of the Act of April 17, 1876 (Purdon's Pennsylvania Statutes, Title 15, Sec. 595, Appendix, *infra*, p. 33), and was referred to as a sale in the resolutions of the board of directors of the corporations involved, in the application to the Public Service Commission and in the Commission's orders. (R. 103, 108.) Besides agreeing to assume the liabilities of the North Penn Company, the Northern Power Company, as additional consideration for the transfer, paid cash sufficient to retire the preferred stock of the North Penn Company and exchanged common stock for common stock of the North Penn Company. (R. 103.)

Among other liabilities of the North Penn Company which the Northern Power Company assumed was the liability on certain First Mortgage Thirty Year 6% Sinking Fund Gold Bonds, due February 1, 1953, which had been issued by the North Penn Company in 1923 at a discount, and which constituted a prior lien on the assets transferred. (R. 103.) The principal amount of the bonds outstanding on the date of the transfer was $552,700. (R. 103.) The unamortized debt discount and expense incurred upon the issuance and sale of the bonds were transferred as a deferred charge asset on the books of the Northern Power Company. (R. 104.)

The trust agreement under which the bonds were issued provided that they might be called and re-

deemed at 105% of the principal amount on any interest date up to February 1, 1933. (R. 103.)

Later in 1926 the Northern Power Company retired a portion of these bonds in the principal amount of $368,900 at 105% plus accrued interest. In 1927 it retired the remaining bonds in the principal amount of $183,800 at the same price. (R. 103.)

On or about June, 1926, the Northern Power Company acquired all of the assets of the Susquehanna County Light & Power Company, a Pennsylvania company organized in 1913 (hereinafter called the Susquehanna Company). (R. 63.) This transfer was effected pursuant to the same Pennsylvania statute as the North Penn transfer, and like that transfer, was characterized as a sale in all of the documents relating to the transaction, and had the approval of the Public Service Commission of Pennsylvania. (R. 103–104, 108.) The consideration for the transfer, in addition to the assumption by the Northern Power Company of the liabilities of the Susquehanna Company, was preferred and common stock of the Northern Power Company issued in exchange for the surrender of stock, consisting only of common, of the Susquehanna Company. (R. 103–104.)

Among the liabilities assumed by the Northern Power Company was the liability upon certain First Mortgage 6% Gold Bonds due December 15, 1943, issued by the Susquehanna Company in 1912 at a discount. These bonds constituted a prior

lien on the assets transferred. The unamortized discount and expense incurred by the Susquehanna Company in issuing these bonds was transferred as a deferred charge asset to the books of the Northern Power Company. (R. 103, 104.)

The trust agreement under which the bonds were issued provided that they might be called and redeemed at 105% of their face value. On July 23, 1926, the Northern Power Company redeemed all of the outstanding bonds in the principal sum of $600,000 at that price. (R. 103, 104.)

The funds for the retirement of the North Penn Company bonds and the Susquehanna Company bonds were obtained from the sale in 1926 of $1,950,000 principal amount of Northern Power Company first and refunding bonds, Series A, due June 1, 1956. (R. 104.)

At the time of the retirement of $368,900 of the North Penn bonds in 1926 and of the retirement of $183,800 of that company's bonds in 1927, the balances of the unamortized debt discount and expense applicable thereto were $47,058.08 and $23,441.71, respectively. (No. 492, R. 63; No. 493, R. 76.) Those items were not taken as an expense on the books of the Northern Power Company, but were transferred to debt discount and expense applicable to the refunding issue. (R. 104.) In the consolidated return for 1926, the Northern Power Company claimed a deduction of $587.40 for amortization of bond discount and expenses incurred in the issuance and sale of the Susquehanna

Company bonds. On its books it did not treat as an expense the unamortized debt discount and expense of $19,922.11, which remained when the bonds were redeemed later in 1926. (No. 492, R. 64–65; No. 493, R. 76.)

It does not appear from the record whether either the North Penn Company or the Susquehanna Company was ever dissolved nor does it appear whether their stock was ever actually surrendered for cancellation.

Before the Board of Tax Appeals it was contended that the petitioner's affiliate, the Northern Power Company, was entitled to deductions for 1926 and 1927 for unamortized discount and expense on the North Penn bonds in the aggregate amounts of $47,058.08 and $23,441.71, respectively, and that for 1926 it was entitled to deduct $19,922.11 representing unamortized bond discount and expense with respect to bonds issued by the Susquehanna Company. (R. 107.)

The Board of Tax Appeals sustained the Commissioner on these issues and determined deficiencies of $24.21 and $3,164.80 for 1926 and 1927, respectively. (No. 492, R. 109; No. 493, R. 117.)

Upon appeal the Circuit Court of Appeals affirmed the Board's decision.

SUMMARY OF ARGUMENT

This case presents the same question that is involved in *Helvering* v. *Metropolitan Edison Company* and *Helvering* v. *Pennsylvania Water &*

Power Company, now pending before this Court on writs of certiorari to the Circuit Court of Appeals for the Third Circuit, Nos. 486 and 487, present Term. There is no difference in the applicable statutes and regulations involved, and we believe that there are no material differences in the facts. The question in all three cases is whether a Pennsylvania corporation which redeems at a premium, before maturity, bonds issued at a discount by a Pennsylvania subsidiary whose assets the parent has acquired and whose liabilities it has agreed to assume, may deduct the unamortized discount and expenses incurred by the subsidiary in issuing the bonds. In each instance, except with respect to one issue of bonds involved in the *Metropolitan Edison* case, the agreement to acquire the assets and assume the liabilities of the subsidiary was made pursuant to Section 595, Title 15, of Purdon's Pennsylvania Statutes (Appendix, *infra,* p. 33).

The decided cases established the general rule that only the corporation which issues bonds may deduct amortization of bond discount and expense, and that a corporation which has acquired the assets and agreed to assume the liabilities of the corporation which issued the bonds may not do so. The only recognized exception to the rule occurs in cases where there has been a true merger or consolidation, the life of the corporation issuing the bonds continuing in the successor and the successor

becoming liable for the debts of the issuing corporation by operation of law. In such cases only has the successor been allowed the deduction.

For reasons stated at some length in our brief in Nos. 486 and 487, this case does not come within the exception. Section 595 relates to sales and not to mergers. Moreover, it does not make the purchaser liable for the seller's debts by operation of law, and the decisions of the Pennsylvania courts construing that section do not hold that it does; nor is the selling corporation continued in existence within the purchaser under that statute.

The applicable statutes and regulations do not warrant a broadening of the exception to include this case. The transferee is a different taxable entity from the corporation issuing the bonds and is not entitled to the deductions which its predecessor might have claimed, had the predecessor continued in existence. On the other hand, the transferee as a separate entity, has sustained no loss measured by the unamortized bond discount and expense.

There were no mergers in this case, even within the definitions on which the petitioner relies. But if for some purposes the transfers of assets under Section 595 may be referred to as mergers, they did not have the effect of making the purchaser liable for the debts of the seller by operation of law, and did not continue the existence of the seller within the purchaser. Hence the purchaser cannot be re-

garded as the same corporation which issued the bonds.

Contrary to the petitioner's contentions, the Pennsylvania decisions clearly establish that the purchaser under that statute is not liable to creditors of the seller unless it may be held liable upon the principle of a fraudulent conveyance. A liability which does not arise from the mere fact of a transfer under Section 595, but arises only in the case of a fraudulent transfer, is not a liability created by operation of law within the meaning of the narrow exception to the rule that the transferee may not deduct amortization of bond discount and expense incurred by its predecessor.

ARGUMENT

THE PETITIONER'S AFFILIATE, THE NORTHERN PENNSYLVANIA POWER COMPANY, MAY NOT DEDUCT AMORTIZATION OF BOND DISCOUNT AND EXPENSES WITH RESPECT TO BONDS ISSUED BY OTHER CORPORATIONS WHOSE ASSETS IT ACQUIRED AND WHOSE LIABILITIES IT ASSUMED BY AGREEMENT

This case presents the same question that is involved in the cases of *Helvering* v. *Metropolitan Edison Company* and *Helvering* v. *Pennsylvania Water & Power Company*, now pending before this Court on writs of certiorari to the Circuit Court of Appeals for the Third Circuit, Nos. 486 and 487, present Term. The question in all three cases is whether a Pennsylvania corporation which redeems at a premium before maturity bonds issued at a discount by a Pennsylvania subsidiary whose assets

the parent has acquired and whose liabilities it has agreed to assume, may deduct the unamortized discount and expenses incurred by the subsidiary in issuing the bonds. In each instance, except with respect to one issue of bonds involved in the *Metropolitan Edison* case, the agreement to acquire the assets and assume the liabilities of the subsidiary was made pursuant to Section 595, Title 15, of Purdon's Pennsylvania Statutes (Appendix, *infra*, p. 33). In this case the court below held that the transferee was not entitled to the deduction. In the *Metropolitan Edison Company* case and the *Pennsylvania Water & Power Company* case the Circuit Court of Appeals for the Third Circuit held that the deduction was allowable.

In our brief in Nos. 486–487 we have pointed out that the decided cases establish the general rule that only the corporation which issues the bonds may deduct amortization of bond discount and expense and that a corporation which has acquired the assets and agreed to assume the liabilities of the corporation which issued the bonds may not do so. *Turner-Farber-Love Co.* v. *Helvering*, 68 F. (2d) 416 (App. D. C.); *American Gas & Elec. Co.* v. *Commissioner*, 85 F. (2d) 527 (C. C. A. 2d); *American Gas & Electric Co.* v. *United States*, 17 F. Supp. 151 (C. Cls.). We have further pointed out that the only recognized exception to the rule is that when there has been a true merger or consolidation, the life of the corporation issuing

the bonds continuing in the successor and the successor becoming liable for the debts of the issuing corporation by operation of law, the successor has been allowed the deduction. *American Gas & Elec. Co.* v. *Commissioner, supra; American Gas & Electric Co.* v. *United States, supra; New York Cent. R. Co.* v. *Commissioner,* 79 F. (2d) 247 (C. C. A. 2d), certiorari denied, 296 U. S. 653; *Western Maryland Ry. Co.* v. *Commissioner,* 33 F. (2d) 695 (C. C. A. 4th).

In Point I of our brief in Nos. 486 and 487 we took the position that those cases did not come within the exception for the reason that Section 595 does not require, and the decisions of the Pennsylvania courts construing that section do not hold, that the purchaser becomes liable for the seller's debts by operation of law; and for the further reason that under that section existence of the seller is not continued within the purchaser.

In Point II of that brief we made the point that the exception should not be broadened to include cases where a successor corporation acquires the assets and assumes the liabilities of its predecessor without effecting a merger or consolidation having the incidents just described, for reasons which may be summarized as follows: (1) the statute and regulations in terms permit the deduction only to the corporation issuing the bonds; (2) the successor corporation in such a case is a different entity, not entitled to the deductions which its predecessor

might have claimed; (3) the successor as a separate entity has sustained no loss measured by the unamortized bond discount and expense.

The arguments in those cases apply equally to this case.

In this case the transferor corporation claiming the deduction is not the petitioner itself but its affiliate, the Northern Power Company, which in 1926 acquired the assets of two of its subsidiaries, the North Penn Company and the Susquehanna Company, and agreed to assume their liabilities. (R. 102–103.) Both transfers were effected pursuant to Section 595. (R. 104–105.) The consideration for the transfer of the assets of the North Penn Company was the assumption of its liabilities by the Northern Power Company, cash for the retirement of the North Penn Company's preferred stock, and the issuance of common stock of the Northern Power Company in exchange for the North Penn Company's common stock. (R. 103.) The consideration for the transfer of the Susquehanna Company's assets was the assumption of that company's liabilities by the Northern Power Company and preferred and common stock of the Northern Power Company which was exchanged for common stock of the Susquehanna Company. (R. 103–104.) In 1926 the Northern Power Company redeemed at a premium before maturity bonds of the Susquehanna Company in the principal amount of $600,000. (R. 103–104.) In 1926 and

1927 the Northern Power Company also redeemed at a premium before maturity bonds of the North Penn Company in the principal amounts of $368,900 and $183,800, respectively. (R. 103.) The bonds of the Susquehanna Company and the North Penn Company had been issued at a discount and those companies had incurred certain expenses in issuing them. (R. 103.) The petitioner claims a deduction for the portion of discount and expense not previously amortized in the consolidated returns for 1926 and 1927 filed in behalf of itself and other affiliated corporations, including the Northern Power Company. (R. 103, 107.) The deductions claimed with respect to the North Penn Company bonds are $47,058.08 for 1926 and $23,441.71 for 1927. (R. 107.) The deduction claimed with respect to the Susquehanna Company bonds is $19,922.11 for 1926. (R. 107.)

This case arises under the Revenue Act of 1926, whereas the *Metropolitan Edison Company* case involves both the Revenue Act of 1926 and the Revenue Act of 1928; and there are no differences in the applicable provisions. Nor are there any apparent material differences in the facts in this case and those involved in the *Metropolitan Edison* case and the *Pennsylvania Water & Power Company* case, except in so far as the former involves the claimed deduction with respect to bonds issued by the Metropolitan Power Company, the assets of which company were not acquired pursuant to the Pennsylvania statute.

It is true that in those cases the only consideration given for the assets transferred was the agreement of the transferee to assume the debts of the transferor and to surrender the stock of the transferor for cancellation; whereas in these cases the transferee, as additional consideration, also exchanged its stock for stock of the transferors.[3] We do not believe that that distinction affects the case in any way. It should also be noted that in this case the deduction is claimed in the consolidated returns by the petitioner's affiliate and not by the petitioner itself; but, that distinction also is unimportant.

Most of the petitioner's contentions are answered in our brief in Nos. 486 and 487, and we incorporate Points I and II of that brief herein by reference, and will serve copies on opposing counsel. In addition, however, we wish to reply to certain specific arguments of the petitioner in this case.

The petitioner argues that transfers effected under Section 595 are mergers (1) because the term "merger" is properly defined as "the uniting of two or more corporations by the transfer of property to one of them, which continues in existence, the others being merged therein," citing 15 Fletcher Cyclopedia Corporations (Perm. Ed.),

[3] The record fails to disclose whether the stock of the transferors was ever subsequently surrendered for cancellation in these cases or whether the transferors were ever dissolved.

Sec. 7041, pp. 7–8, and 8 Thompson on Corporations (Third Ed.), Sec. 6012, p. 66; and (2) because the Pennsylvania cases hold that a merger may be accomplished under Section 595, citing *Penna. Utilities Com.* v. *Pub. Serv. Co.*, 69 Pa. Super. Ct. 612; *Y. Hav. W. & P. Co.* v. *Pub. Serv. Com.*, 287 Pa. 241.

In reference to the first argument, we take the position that even under the above-quoted definition of merger, there were no mergers in this case, but that in any event the problem here is not resolved by determining that transfers under Section 595 come within the terms of that definition.

The petitioner argues that under the quoted definition the essential characteristic of a merger is that the corporation which disposes of its assets must cease to exist as an independent corporation. The argument assumes that that is true with respect to transfers of assets effected under Section 595. Section 595 does provide that after a corporation has disposed of its franchises and assets to another corporation, those franchises and assets shall vest in the purchaser and the seller shall "cease to exist." But, as the court below pointed out, in *Merwine* v. *Mt. Pocono Light & Imp. Co.*, 304 Pa. 517, the Supreme Court of Pennsylvania held (pp. 521–522) that the phrase "cease to exist" in Section 595 referred primarily to a cessation of carrying on the business for which the selling corporation was created, and the court stated that the

defendant corporation in that case not having been legally dissolved, its condition was rather that of an inactive corporation than of one altogether dead. Upon that theory it permitted the corporation which had sold its assets to be sued. The decision in that case, therefore, establishes that a sale of assets under Section 595 does not automatically terminate the corporate existence of the seller and that the seller continues separately in existence until it is dissolved. If, therefore, it be essential to a merger that the transferor automatically lose its independent existence upon the transfer, a transfer under Section 595 does not accomplish that result. It is evident from the decision in the *Mt. Pocono* case that Section 595 does not itself "merge" the seller in the purchaser. Without such a merging one of the requirements of the definitions cited by the petitioner is absent. True mergers cannot be effected without the authority of state law, and the authority to merge must be clearly expressed. See 15 Fletcher Cyclopedia Corporations, Sec. 7048, p. 26.

But we submit that under the decided cases the question is not whether a transfer effects what for some purposes or within certain definitions may be termed a merger or consolidation, but whether it effects a merger or consolidation which has the effect of making the transferee liable by operation of law for the debts of the transferor and of preserving the existence of the transferor in the trans-

feree. *American Gas & Elec. Co.* v. *Commissioner, supra; American Gas & Electric Co.* v. *United States, supra.* If it be true that to constitute a merger for any purpose the transferor must automatically lose its independent existence as a separate corporation, for the purpose of the question here involved it is required in addition that its existence must at the same time be continued in the transferee. For that reason it is not enough to bring transfers under Section 595 within a general definition of the term "merger".

For the same reason it is unimportant that there are Pennsylvania cases which have loosely referred to transfers under Section 595 as mergers. An examination of those cases indicates that in making such references the court was thinking of mergers of franchises under Section 595 rather than of mergers of corporations. Thus in *Y. Hav. W. & P. Co.* v. *Pub. Serv. Com.*, 287 Pa. 241, the transfer of assets had been attempted not under Section 595 but under the regular merger and consolidation statute. The Public Service Commission refused to approve the transfer upon the ground that an electric light and power company had no authority to merge with a hydro-electric or water power company. The court held that since the vendor had power under its charter to supply water, as well as to develop electric power for commercial purposes, and since the vendee had no power under its charter to supply water, the merger could not

be effected until the power to supply water was surrendered by the vendor. In the course of its decision the court said that a transfer would also have been prohibited if the transaction were made pursant to Section 595, for the reason that that statute also provided that the purchaser could not acquire franchises inconsistent with its charter. It was in that connection that the court made the following statements relied upon by the petitioner (pp. 246, 249):

> There are two forms of consolidation in Pennsylvania, a short and a long form merger. These are accomplished by the Act of 1876, as amended, and the Act of 1909. The Act of 1876, P. L. 33, as amended, provides that such sale may take place if the "franchises are not inconsistent" with this act. And the merger Act of 1909, P. L. 408, permits consolidation between corporations "transacting the same or similar lines of business."
>
> * * * * *
>
> A sale or merger, under the Act of 1876, with its amendment, or the Act of 1909, which is practically the same, cannot take place until the company legally discards the offending power.

It will be noted that the word "sale" as well as the word "merger" was used in the above-quoted excerpts from the court's opinion. But irrespective of that fact, we think it is clear that all the court meant by these *dicta* in reference to Section

595 was that a corporation could not acquire franchises inconsistent with its charter, either by a transfer under Section 595 or by a merger effected under the regular merger statute. It did not hold that for all purposes the two statutes were similar. Its decision is comparable to the decision in *Hey* v. *Springfield Water Co.*, 207 Pa. 38, where the court referred to Section 595 not as effecting a merger of corporations but as effecting a merger of franchises.[4]

It was with respect to the same problem as to acquisition of franchises that it was said in *Penna. Utilities Co.* v. *Pub. Serv. Com., supra,* that (p. 615):

> As a legal consequence the purchase act differs but little from the merger act which is used to some extent to consolidate companies.

In many other Pennsylvania decisions transfers under Section 595 have been referred to as sales. *Greensburg Boro.* v. *W. Water Co.*, 240 Pa. 481; *Koehler* v. *St. Mary's Brew. Co.*, 228 Pa. 648; *Carr* v. *Rochester Tumbler Co.*, 207 Pa. 392; *Maxler* v.

[4] That is probably what Special Deputy Attorney General Stockley had in mind when he made the statement attributed to him in the petitioner's brief (p. 17). According to the petitioner, he stated that Section 311 of the Act of May 5, 1933 (P. L. 383), which authorizes sales of assets but not of franchises, does not have the effect of a merger similar to that formerly authorized by Section 23 of the Corporation Act of 1874, as amended.

Freeport Bank, 275 Pa. 510; *Ringler* v. *Atlas Portland C. Co.*, 301 Pa. 176; *Buist's Estate*, 297 Pa. 537. The opinion in the latter case was written by the judge who had previously written the opinion in the *Y. Hav. W. & P. Co.* case, *supra*.

Nor is the petitioner's suggestion correct that such transfers have been characterized as sales only where the consideration was to be paid in cash. In *Koehler* v. *St. Mary's Brew. Co.*, *supra*, the consideration for the transfer was the assumption of liabilities of the transferor and bonds of the purchaser, and minority stockholders sought to enjoin the sale upon the ground that it was a fraudulent conveyance because of the inadequacy of the price. The court held that under Section 595 a corporation had the absolute right to sell its assets for a price fixed by the corporation by vote of the majority stockholders and that even if the price were inadequate, the minority stockholders could not enjoin the sale, though under the Pennsylvania law they were entitled to be paid in cash for their shares of stock.

But as we have stated, even if the decisions of the Pennsylvania courts consistently referred to transfers effected under Section 595 as mergers, it would not determine the issue in this case. The question is whether the transfer, whether called a merger or not, has the effect of making the purchaser liable for the debts of the seller by operation of law and of preserving the continuity of the seller's exist-

ence within the purchaser so that there is justification for the theory that the corporation claiming the deduction is the corporation that issued the bonds, and hence is entitled to the deduction.

The petitioner cites *Lansdowne Bank & Trust Co.'s Case*, 323 Pa. 380, as authority for the view that Section 595 does require the purchaser to assume the debts of the seller. But that case involved a transfer of assets from one bank to another and Section 595 does not apply to such transfers. See *Maxler* v. *Freeport Bank*, 275 Pa. 510. In the *Lansdowne* case, the purchasing bank had taken over all of the deposits and agreed to assume the liabilities and obligations of the selling bank, and the issue decided was whether the purchaser was required to furnish a bond to a certain school district before receiving any of its deposits. In holding that it was the court did state that where one corporation purchases the business and assets of another, it succeeds to all the other's rights and is bound as well by its obligations; but it made that statement with reference to a case where liabilities were actually assumed by agreement and must be deemed to have intended its phrase (p. 385) "purchases the business and assets" to reflect that limitation. In any event, Section 595 was not involved, and whatever the court said has no application to sales made pursuant to that section.

Section 595 does not provide that the purchaser shall be liable for the debts of the seller. It leaves

the parties free to fix the terms of the contract. See *Koehler* v. *St. Mary's Brew. Co.*, 228 Pa. 648. No Pennsylvania court has held otherwise, and in *Merwine* v. *Mt. Pocono Light & Imp. Co., supra,* where there had been a transfer of assets under Section 595, the court refused to direct the substitution of the purchaser as a defendant in a suit against the seller for damages for personal injuries and held that the proper course was to sue the seller. This result would have been wholly unjustified if under Section 595 the purchaser became liable for the debts of the seller by operation of law.

It is true that in that case, after holding that the proper course was to sue the seller, the court intimated but did not decide that the pleadings laid a basis for proof which, if adduced might justify findings which would give the judgment-creditor the right of realization against the transferred assets in the hands of the transferee. From the allegations to which it referred as laying a basis for such proof, as well as from the discussion of the trust fund doctrine which preceded the mention of this possible liability, it is clear that the court meant that the transferee might be subsequently determined to be liable upon the principle of a fraudulent conveyance.[5] If the statute created the liability no proof of the circumstances of the transfer would have been necessary. The court in

[5] See discussion of that case in *Weinroth* v. *Homer B. & L. Assn.*, 310 Pa. 265.

the *Mt. Pocono* case concluded its statement on that subject as follows (p. 523):

> Whatever the liability of the Pennsylvania Power & Light Company may or may not prove to be, we pass that point and note that the proper course at the present state of proceedings requires plaintiff first to proceed to judgment against defendant if she can, and, having secured judgment, to levy where defendant's assets liable for the judgment may be found.

By the latter statement the court referred to one method by which a creditor may proceed in the case of a fraudulent conveyance. The statute of 13 Elizabeth, c. 5, is in force in Pennsylvania as a part of the common law of that State (Purdon's Pennsylvania Statutes, Annotated (Permanent Ed.), Title 39, p. 262). See also *Golder* v. *Bogash* (*Tr. Co. of Phila.*), 325 Pa. 449. In addition, a Uniform Fraudulent Conveyance Act was enacted May 21, 1921 (P. L. 1045), Purdon's Pennsylvania Statutes, Annotated (Permanent Ed.), Title 39, Secs. 351–360. Section 359 provides that in the case of a fraudulent conveyance or obligation the creditor may have the conveyance set aside or the obligation annulled to the extent necessary to satisfy his claim or may disregard the conveyance and attach or levy execution upon the property conveyed. The claimant in the *Mt. Pocono* case, *supra*, was a creditor within that definition of the term in that statute. See Section 351.

Under those statutes the creditor may pursue various courses of action. He may by proper proceedings in equity fasten a constructive trust as to the debtor's assets on the successor as trustee, with liability to account for such assets. *Peoples Sav. & Dime Bk. & T. Co.* v. *Scott*, 303 Pa. 294; *Halpern* v. *Grabosky*, 296 Pa. 108. He may in case of concealment file a bill in equity to discover assets and impose liability. *Mount Union Borough* v. *Kunz*, 290 Pa. 356. Where real estate is involved, he may also secure a judgment against the debtor; cause execution to be levied on the debtor's interest in the transferred real estate; acquire title by purchase at the subsequent sale; and bring an action of ejectment against the transferee to test whether there was a fraudulent conveyance. *Hyde* v. *Baker*, 212 Pa. 224; *Sauber* v. *Nouskajian*, 286 Pa. 449; *Conemaugh I. W. Co.* v. *Delano C. Co.*, 298 Pa. 182; *Penna. Trust Co.* v. *Schenecker*, 289 Pa. 277.[4]

But none of those remedies would avail the claimant anything unless he could prove fraud. See *Koehler* v. *St. Mary's Brew. Co.*, *supra*. It was not available merely because there had been a transfer under Section 595. The mere fact that proof of fraudulent circumstances was necessary indicates

[4] Sometimes after the creditor has sued the debtor, secured judgment, and levied execution, the transferee of the assets levied upon claims them and the issue as to whether there was a fraudulent conveyance is decided on the sheriff's interpleader. *Delphia K. M. Co.* v. *Richards*, 62 Pa. Superior Ct. 9.

that the transfer under Section 595 does not in itself create the liability.

The petitioner argues that the statutes relating to fraudulent conveyances do not apply where there is a transfer under Section 595 except in the case of sales for cash, but it cites no authority in support of that view. In *Mount Union Borough* v. *Kunz, supra,* the consideration for a transfer effected under Section 595 was partly cash and partly assumption of indebtedness. The court recognized that the creditor might have had a remedy in equity against the transferee if the conveyance was fraudulent although that was not merely a cash transaction. See also *Koehler* v. *St. Mary's Brew. Co., supra.* In *Berkovitz's Appeal,* 319 Pa. 397, where one bank acquired the assets of another, (a transaction which does not come under Section 595) the court, without saying whether or not there was a merger or merely a sale, stated that it was settled that the creditors of a corporation might follow the assets of another into a new corporation where there had been a merger, *or in cases of fraudulent transfer,* citing *Halpern* v. *Grabosky, supra; Merwine* v. *Mt. Pocono Light & Imp. Co., supra;* and *Delphia K. M. Co.* v. *Richards, supra.*

In the light of the Pennsylvania statutes and decisions just discussed, we submit that there can be no question but that in referring to a possible liability of the transferee as a purchaser *cum onere,* the court in the *Mt. Pocono* case meant that it might

be liable under the principles applicable to fraudulent conveyances if proof of appropriate facts were adduced. It seems clear from the fact that such proof was necessary that the transferee was not liable merely by virtue of the uncontested fact of the transfer of assets under Section 595.

The petitioner says (Br. 30–31) the court in the *Mt. Pocono* case stated that a transfer of assets by a corporation to an affiliated corporation is simply a formality and the transfer in reality is a merger of the two companies. We submit that the opinion cannot be so construed. If the court in that case had meant that a sale of assets by a corporation to its parent under Section 595 effected a merger which made the transferee liable for the debts of the transferror by operation of law, it would have directed the transferee to be substituted as a party defendant. Its refusal to do so can only be explained upon the theory that in stating that the pleadings laid a foundation for evidence and findings that (p. 524) "the transaction between the two corporations was in reality a merger, or such union of interests as, in law, caused the buying corporation to assume the defendant's obligations", the court had in mind a different kind of liability. That conclusion is strengthened by the court's direction to the claimant to proceed to judgment against the defendant (the transferor) and having secured judgment to levy upon its assets wherever they could be found. The suggested remedy was

appropriate in the case of a fraudulent conveyance but wholly inappropriate if the transferee was directly liable by operation of law as an unqualified consequence of the mere fact of a transfer.

We submit, therefore, that in these cases there were merely sales of assets, but that if for some purposes the transfers be considered as effecting mergers, they were not mergers having those characteristics which a merger must have to enable the transferee to deduct amortization of bond discount and expense with respect to bonds issued by the transferor. The Northern Power Company is a different taxpayer from the companies which issued the bonds. It is not entitled to the deduction which its affiliates might have claimed if they had redeemed the bonds; and as a separate entity it has sustained no loss measured by the unamortized bond discount and expense which it should be permitted to deduct as representative of any loss or expense it suffered.

The petitioner argues that to construe the statute and regulations as denying the deduction to a parent company which has purchased the assets of its affiliates and agreed to assume their liabilities is unjust, because there is no reasonable probability that any loss representative of the unamortized debt discount and expense has been compensated for. We do not concede that under the statutes and regulations the allowance of the deduction can be made

to depend upon whether or not there has been such compensation in fact. Much less may it be made to depend upon a mere presumption that there is a reasonable probability of uncompensated loss. There is no basis for a presumption that in arranging the terms of the transfer the possibility of such a loss has not been taken into account. The shifting of the economic effect of the loss was wholly within the control of the parties. The burden should be on the claimant to show that a loss deductible under the statute has actually fallen upon the transferee.

We submit that the effect is merely to deprive the parent of a benefit when it has borne no burden. In this case the Northern Power Company agreed to pay off the bonds of its affiliates, but it received assets in exchange for its obligation. The obligation is merely a part of the consideration paid for the assets, additional consideration being given through an exchange of stock for stock. It cannot be determined which corporation benefited by the transaction, but in any event the gain or loss from that transaction is not here involved.

It is true that if, instead of assuming the liability on the bonds, the Northern Power Company had paid cash to its affiliates to enable them to redeem their bonds, the affiliates would have been permitted to deduct the unamortized bond discount and expense. But in that situation the affiliates would

have been taxed on whatever gain was realized on the receipt of cash for assets. Thus they would have had the benefit of the deduction but would have had the burden of paying a tax on the sale.

CONCLUSION

The decisions of the court below should be affirmed.

Respectfully submitted.

ROBERT H. JACKSON,
Solicitor General.
JAMES W. MORRIS,
Assistant Attorney General.
SEWALL KEY,
HELEN R. CARLOSS,
Special Assistants to the Attorney General.

FEBRUARY, 1939.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 200. When used in this title—

* * * * * *

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

* * * * *

SEC. 212. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the

term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the computation shall also be made in the manner provided in section 217.

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise: * * *

* * * * *

Purdon's Pennsylvania Statutes, Annotated (Permanent Edition), Title 15:

SEC. 595. *Reduction of capital stock; change in value of shares; conveyance of franchise and property.*—Any corporation created under the provisions of this act, and any corporation of the classes named in the second section hereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capital stock or alter and change the par value of the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first and twenty-second sections of this act; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this act, its franchises; and all its property, real, personal and mixed, and therafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid: *Provided,* That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and property, shall have filed with the Secretary of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed sale, assignment, disposition and conveyance; and that all taxes due the Commonwealth of Pennsylvania have been paid up to and including such date: * * *

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

> ART. 545. *Sale and retirement of corporate bonds.*—(1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (See section 234 and article 563.) (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.
>
> (2) (*a*) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the

purchase price is gain or income for the taxable year.

(3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

ART. 563. *Sale of capital stock, bonds, and capital assets.*—A corporation sustains no deductible loss from the sale of its capital stock. (See article 543.) If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. (See article 545.) Any loss sustained by a corporation upon the sale of its capital assets, computed as provided in sections 202–204 and articles 1561–1603, subject to the limitation provided in section 234 (a) (4) as to the purchase and sale of stock or securities, is deductible.

U. S. GOVERNMENT PRINTING OFFICE: 1939

SUPREME COURT OF THE UNITED STATES.

Nos. 492 and 493.—October Term, 1938.

General Gas and Electric Corporation, Petitioner, *vs.* Commissioner of Internal Revenue.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[April 3, 1939.]

Mr. Justice Roberts delivered the opinion of the Court.

These are companion cases to Nos. 486 and 487 and involve the same question. The Circuit Court of Appeals held that conveyances by subsidiaries to the taxpayer, consummated under the Act of April 29, 1874, did not constitute mergers so as to authorize the taxpayer to take a deduction for unamortized bond discount and expense in respect of bonds issued by the subsidiaries prior to the conveyance.

For reasons given in Nos. 486 and 487 the judgments must be reversed.

So ordered.

A true copy.

Test:

Clerk, Supreme Court, U. S.